

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-102284-08

Date:

July 11, 2008

X =

Grantors =

Trust 1 =

Trust 2 =

Trust 3 =

D1 =

D2 =

Year 1 =

Dear _____ :

This responds to a letter dated December 21, 2007, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X made an election to be treated as an S corporation effective D1. A and B created Trust 1 on D2 of Year 1 and funded it with X stock. Pursuant to its terms, Trust 1 immediately divided into Trust 2 and Trust 3. Trust 2 and Trust 3 are represented as being eligible to be electing small business trusts (ESBTs). The primary beneficiaries of Trust 2 and Trust 3 also have withdrawal powers over their respective trusts that would cause them to be the owners of a portion of their respective trusts under §§ 671 and 678. The trustee of Trust 2 and Trust 3 failed to make ESBT elections. X's S corporation election terminated effective D2 of Year 1.

X represents that the failure to file the ESBT elections for Trust 2 and Trust 3 was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual. Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder of an S corporation.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(B), an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a PCB, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service

center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D2 of Year 1 and that the termination was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 of Year 1 and thereafter, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1361(d). Trust 2 and Trust 3 will be treated as ESBTs from D2 of Year 1 and thereafter. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

This ruling is conditioned upon the trustee of Trust 2 and Trust 3 filing appropriately completed ESBT elections effective D2. The ESBT elections must be filed within 90 days following the date of this letter and a copy of this letter should be attached to the elections. It is additionally conditioned on Trust 2, Trust 3, and their beneficiaries filing within 90 days following the date of this letter amended returns for Year 1 and subsequent taxable years consistent with the treatment of Trust 2 and Trust 3 as ESBTs and the beneficiaries as the owners of their respective portions of Trust 2 and Trust 3 under §§ 671 and 678. A copy of this letter should be attached to each

such amended return. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion on whether Trust 2 and Trust 3 are otherwise eligible to be ESBTs.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, copies of this letter are being sent to X's authorized representatives.

Sincerely,

MELISSA C. LIQUERMAN
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes